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MEMORANDUM

April 22, 2005

TO: CD Specialists and ADR Grantees

FROM: Stephen Lathom, Homebuyer Development Specialist

RE: ADR Proforma and Intelligrants Updates

In response to feedback from staff and grantees, a variety of changes have been made to the ADR proforma and to the manner in which ADR projects flow through the Intelligrant's system. These changes are detailed in the attached document, titled April 2005 ADR Proforma and System Updates. Also attached to this memo and distributed via email is a new version of the ADR proforma in Excel format. This new version matches the various changes we have made to the proformas in the system.

While there are many tweaks and updates to the proforma, none of them represent a change in MSHDA policy. Instead, the changes are intended to ensure the system and the proforma are more user friendly, provide clearer information to grantees and staff, and more consistently reflect existing policy.

The implementation of two key changes—the elimination of the contingency from project proformas and the slightly revised formula by which the setup amount is calculated—will result in automatic changes in the setup amount for about half of the ADR projects in the system. In most cases, neither CD Specialists nor Grantees need to take any action. The new setup amount is generally the result of removing the contingency from the previous setup amount.

The automatic change to the setup amount will cause thirteen projects to be setup for less than the funds previously billed against a given project. In these cases, some action is required to adjust either the proforma or the billings against a project. A review of the new Activity Billing Summary will assist in determining the cause of the over-billing as well as a possible solution. Below are three likely scenarios and solutions:



1. Scenario: The grantee has incurred costs from the contingency and billed those costs without revising the proforma to reflect the actual amount of construction expenses on Line A-4 of the proforma.

Solution: The grantee should revise their proforma to reflect the actual costs of construction on Line A-4 (or possibly Lines A-5 or A-6). This will result in an increased setup amount that likely will exceed the amount already billed against the project. Once this revised proforma is approved, the project can proceed as normal.

2. Scenario: If the grantee has drawn down the contingency against incurred project expenses but the project has not actually experienced cost increases due to change orders, there are two explanations.

Solution: Either the “excess” MSHDA funds supplanted other funding in the project—such as the construction loan or grantee equity—and a revised proforma reducing the amount of leveraged funds in the project will correct the imbalance.

Solution: Or the grantee has simply over-billed the project and needs to submit a “negative” draw on the next FSR Expense Detail Page to “credit” these funds back into Cash on Hand and later charged against other eligible expenses on another project within the grant.

3. Scenario: The grantee may have drawn more developer fee against the project than they are currently eligible to draw.

Solution: The grantee should submit a negative draw for the over-billed expense, making sure to check the Developer Fee Item box on the Expense Detail Form. This will return the funds to Cash on Hand with the grantee, and these funds will be credited to the next eligible expense the grantee incurs.

CD Specialists will meet on Monday, April 25th to review the changes to the proforma and prepare them for questions from grantees. The changes will also be highlighted during the next series of ADR training sessions we are planning for this summer. Those dates will be announced in the near future.

In the meantime, if you have questions or run into unanticipated problems, please let me know so I can explain and/or help troubleshoot any bugs that were not identified during testing of these changes.

Attachments

APRIL 2005 ADR PROFORMA AND SYSTEM UPDATES

Proforma Formatting Updates: Many of the changes are related to the formatting of figures entered or returned on various lines of the proforma. Those changes are detailed below:

1. Due to the elimination of some lines and the addition of others, line numbering throughout the proforma may have changed. Additionally, we've re-labeled the sections of the proforma consecutively without any gaps. Previously Section F was missing, so subsequent sections have now been relabeled as Sections F, G, and H. Throughout this memo, I will refer to lines by their new numbers.
2. Line B-3, "allowable LTV of end mortgage," will now allow grantees to enter loan to value ratios in excess of 100%. Some lending programs will finance more than 100% of the purchase price of a home to allow buyers to finance some portion of their closing costs and prepaid expenses. Previously the proforma did not allow entry of LTV ratios of 100% or more.
3. Line B-6, "local total tax rate (mills)," will now allow entry of a millage rate to two decimal points (e.g. 44.78 mills). Previously only integers were accepted in this cell.
4. Line B-24, "interest rate," will allow entry to three decimal points (e.g. 5.357%). Previously it only allowed entry to two decimal points.
5. Line F-2, "PITI 25-33%" will return a value to one decimal point (e.g. 29.3%). Previously this line only returned an integer result, and in some cases this was confusing when grantees received a "No Go" while the result appeared to be within the range. For example, a PITI ratio of 33.4% rounded to 33% in the line, but the compliance check was still returning a "No Go" because the ratio exceeds 33%.
6. Line F-3, "buyer's cash investment," will return a value to two decimal points (e.g. 1.21%) rather than simply returning an integer. When buyer's had less than 1% cash invested in a project (for example only \$900 when they should be investing \$1,000), this line gave a "No Go" while the numeric reference was rounded to 1%. In such a case, the proforma would now return 0.90%.
7. The title of grantee-completed lines on the proforma has been reformatted in blue text. This was done to help both staff and grantees more easily distinguish which lines are entered and which are calculated while reviewing a completed proforma.

Proforma Structural Changes: In addition to the formatting changes in the ADR proforma, structural changes in various entry lines and formulas for key result lines have been changed. Those updates are detailed below:

1. The manner of entering or requesting the Developer Fee within a project proforma has been modified. Grantees will now be asked to enter the dollar amount of the requested developer fee on line A-11. Previously grantees requested the developer fee as a percentage of the project, and the proforma then calculated the dollar amount of the fee. This change was made to more easily accommodate situations where the developer fee amount on a given project is reduced for one reason or another—often to accommodate an additional project within a grant that may be possible with a slightly reduced developer fee.

Related to this change, a new Line F-10, “developer fee requested acceptable,” has been added. If the developer fee requested is larger than the maximum developer fee allowed on Line A-10, this line will result in a “No Go”. The maximum developer fee shown on Line A-10 still will not be increased in proportion to increased project costs after the Contract Proforma is approved.

2. At the project proforma stage, we have eliminated the contingency (formerly line A-7). Including the contingency in the project setup amount has led to confusion about the amount of MSHDA funds needed for a project and to over-billing individual projects. When completing an application, grantees will still be able to budget a contingency into their request (by showing it in Section H of the application proforma), but project proformas will no longer carry a contingency amount.

Grantees may include a contingency in their estimate of construction costs on Line A-4 of the Setup Proforma, but starting with the Contract Proforma, Line A-4 should represent the actual amount of the construction costs based on the current contract. If change orders drive the cost of the project up, grantees may submit revised proformas as needed.

3. The manner of calculating the Homebuyer Subsidy on line D-12 has been modified. Previously, the proforma would not return a value less than \$1,000. When a proforma was filled out showing more resources from a buyer than were otherwise required to purchase the house, the Homebuyer Subsidy would still show as \$1,000. However, projects never end up closing in this manner, and as projects moved toward completion, the reduction in anticipated cash at the closing table impacts the setup amount and can leave a gap in the grant budget.

Line D-12 is now calculated by simply subtracting the funds available from the buyer at closing on Line D-11 and any amount shown on line D-10 (having a figure on D-11 is rare) from the total investment expected of the buyer at closing on D-4 without a minimum result built into the formula.

Related to this change, there is a new compliance check on Line F-9. If the Homebuyer Subsidy is less than \$1,000, this line will return a “No Go”, and you may be required to restructure your proforma.

4. A new line has been added to Section D. Line D-14, “soft costs paid from sales proceeds,” allows grantees to clearly record any non-interest soft costs that are paid from the proceeds of sale. Examples may include unpaid property taxes or utility bills. Previously grantees were instructed to include such costs in the figure entered on Line D-13, repayable to construction loans.

Moving forward, this line will continue to treat soft costs paid from sales proceeds as deductions from the developer fee, but having this line more clearly connects the final proforma to the HUD-1 Settlement Statement.

Related to the addition of line D-14, the formula and the title for Line D-16 has been changed. Line D-16, “deduct interest/soft costs paid at closing,” simply adds the interest paid at closing as part of the construction loan repayment on Line D-13 and the soft costs paid at closing on Line D-14. The title on line D-22 has been updated as well, but the formula is unchanged and still references line D-16.

5. The calculation of the setup amount in Section E has been changed. Previously the proforma calculated an “initial” setup for projects and a “final setup/completion” amount for projects.

The “initial” setup calculation ignored the impact of accrued construction interest on the final developer fee payment and the resulting impact on the grant funds needed for the project. The “final” setup amount calculated the impact of developer fee deductions on the grant funds that would be used for a project.

Previously, when the two figures differed, the “final” setup was less than the “initial” setup amount. Having two different setup amounts was confusing to staff and grantees when billing against projects and understanding the final amount of MSHDA funds invested in a project.

The formula for Line E-1, “total setup,” has been modified to account for developer fee deductions at closing on the project setup. The modified calculation on Line E-1 will feed into the figure on Line E-3, “grant funds needed for project.” Since we no longer have an “initial” and a “final” setup amount, the former Line E-4 has been eliminated.

6. Finally, a new line has been added to the Project Evaluation Section. Line G-5 will calculate the buyer’s total debt ratio—or the back end ratio—upon completion of the project. This line adds the buyer’s existing consumer debt on Line B-17, the PITI payment calculated on Line B-30, and Mortgage Insurance payment on Line B-31. It then calculates the ratio of the buyer’s total monthly debt obligation to their gross monthly income.

The Office of Community Development does not have a specific compliance factor or limit on buyer’s total debt ratios, but we have been concerned about some projects that leave buyers with extraordinarily high back end ratios (some in excess of 50% of income). This line will help us evaluate actual practices in the field and may help identify projects where buyers’ chances of long-term success as homeowners are limited.

Activity Tracking Checklist and other Intelligrants System Updates: Finally, the changes to the proforma are related to several other changes in the Intelligrants system that affect how an ADR project moves from setup to completion. Those changes are detailed below:

1. A new column has been added to the Activity Tracking Checklist. This column shows the date each checklist item was completed and will help both MSHDA and grantees better evaluate progress and performance within both individual projects and entire grants.
2. Previously, an error check required that the Income Verification/Demographic Form match the household size and income information entered on the current project proforma. This often required a proforma revision between the Contract Proforma and the Pre-Closing Proforma to update the buyer’s income information in the proforma since at the Contract stage a specific buyer is often not identified.

The new error check compares the Pre-Closing Proforma (and any subsequent proformas) to the Income Verification/Demographic Form. The end result is that both the proforma and the Income Verification/Demographic form will report the same information, but the error check is completed at a more logical step in the process.

Additionally, the location of the Income Verification/Demographic form has been moved within the Activity Tracking Checklist. It now appears immediately above the Pre-Closing Proforma. This is generally a better reflection of the chronological order in which steps on the checklist are actually completed.

3. The timing of the Final Proforma has been changed. Previously, the Final Proforma could not be completed if setup in the final proforma did not equal the total funds drawn against the project. However, the actual closing figures are not usually known until after the Pre-Closing Proforma has been submitted and approved. As those figures change, changes may occur in the setup amount and therefore in the amount a grantee should draw. Again, the practical result was that grantees had to submit a proforma revision after the Pre-Closing Proforma and before the Final Proforma, leading to delays in processing.

With the changes to the checklist, the Final Proforma must now be submitted and approved BEFORE the grantee can bill more than half of the developer fee on a project. In effect, the Final Proforma will precede the final billing against ADR projects. This will allow both the CD Specialist and the Grantee to be sure of the appropriate amounts for the final billing and ensure that the Final Proforma properly corresponds to the HUD-1 Settlement Statement before paying out the balance of the developer fee.

Once the executed Homebuyer Subsidy Mortgage, the original Homebuyer Subsidy Note, and the Settlement Statement have been received by the CD Specialist and recorded in the Activity Tracking Checklist, grantees will be able to submit a Final Proforma for approval.

Additionally, the Homebuyer Subsidy on the Final Proforma must match or be within \$5 of the Homebuyer Subsidy amount as the Homebuyer Subsidy Mortgage documents were actually completed on the system. The +/- \$5 allows for the difference between the HUD-1 Settlement Statement and the proforma that sometimes results from the rounding of figures entered into the proforma. In the vast majority of cases, the Homebuyer Subsidy on the Final Proforma will be within \$1 of the actual Homebuyer Subsidy documents completed at the closing.

4. The most dramatic change to the Activity Menu is the addition of a new tab—the Activity Billing Summary. This summary should assist grantees in determining how much can be billed against a project. The Activity Billing Summary breaks the total project into three pieces: 1) MSHDA funds needed to pay for itemized hard cost expenses included in Lines A-2 through A-6 of the proforma, 2) MSHDA funds needed to fill a gap in cash proceeds at closing on the resale of the unit, and 3) MSHDA funds drawn through the FSR process toward the developer fee.

Because portions of the Developer Fee are often paid from the cash proceeds of the sale or deducted from the final Developer Fee for interest and/or soft costs paid at closing, the gross amount of the Developer fee is not included in the setup amount for most projects. This has been a source of confusion and has caused projects to be billed incorrectly

The new Activity Billing Summary shows the outstanding balance available to bill—for both Hard Costs and Developer Fee—and those balances are now tied to the amount a grantee is able to report on the FSR Expense Detail page. This should dramatically reduce billing errors in the future.